

High C Prices, Pre-Finance Deficiencies and FT in the Balance

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Harvest of 2005

- Co-ops had difficulties meeting contractual obligations;
- Co-op members “defecting”: selling much of production to middlemen
- Roasters and Importers unhappy; some question FT
- Some FT Co-ops collapse

Why?

Highest C prices in Five Years

- increase in worldwide consumption
- reduction in coffee stocks in warehouses
- downturn in yields in Brazil
- speculation, eg by commodity investment funds
- yields down by 20-25% in Mexico and Central America
- growing demand for certain coffees, eg Guatemala Atitlan, Tarrazu Region in Costa Rica
- (unconfirmed) drug money laundering

Result: Increasing C and Increasing Differentials

- $C > \$1.30$; Indonesia, differential of $\$0.80 +$

Why Weren't Co-op Members Delivering?

- With High C prices Middlemen more competitive *vis a vis* FT
- (unconfirmed) middlemen especially well-financed by multinational trading houses
- High C and high differentials – FT only offers \$0.10 over C
- Fixed-price FT contracts
- Consumption/Harvest loans and liquidity constraints
- Many co-ops only had insufficient pre-financing

Focus: pre-finance

- Why? Identified by many co-ops and buyers as the key link

How Pre-Harvest Financing Works

- In principle, importer supplies pre-harvest financing for harvest expenses, esp labor
- Often, Importer works through Socially-Responsible Bank, esp Ecologic (Root Capital), or
- Co-op may get funding through regional or national govt initiatives or banks

Example: Oaxaca, Mexico

- In normal year, producers will receive about \$1-1.10/lb green, ie, around \$0.80 – \$0.88/lb parchment
- Pre-financing in September – about \$0.40/lb
- If can't get this from co-op, will often go to middlemen who will pay them, say, \$0.30/lb
- At delivery, co-op often offers \$.80/lb now or \$.68 and something more that \$.12 later

Alternative: Middlemen

- may make consumption loans to farmers early in season (before pre-finance available from co-op) with an agreement to sell coffee at low price later
- pay in full when coffee delivered, unlike co-op
- very common (in all years) for co-op members to sell part of harvest to middlemen to meet liquidity needs

What happened in 2005?

- Middlemen were able to offer credit earlier, or even higher prices
- And were able to respond quickly to price rises - multinational trading houses have faster access to credit than co-ops and get it at a cheaper rate
- Many Co-ops couldn't meet pre-finance obligations
- Co-ops had an especially difficult time getting deliveries from members

What happened in 2005?(cont.)

- Transfair response: co-op members just have to learn to respect contracts, need to be loyal to co-ops when prices high as well as low, etc.” – fine, but not a long-term solution
- Co-ops, importers and roasters in difficult situation – meeting contractual obligations
- Some Co-ops collapsed

Difficulties varied across countries and within countries. Reasons?

1. Social Capital and “moral” commitment to co-op
 - History
 - Co-ops delivering other services
 - Contrasting Nicaragua with Guatemala
 - Moral suasion was sufficient in many cases, called on the “farmer’s conscience”

Difficulties varied across countries and within countries. Reasons? (cont.)

2. Who was on the buying end - “Relationship” model versus standard contractual model
 - Roasters:
 - Eg. GMCR – was flexible with producers. Relationship.
 - Some other roasters/buyers accused the co-ops of trying to cheat them
 - Raises questions about the increasing importance of companies in FT that aren’t as concerned with creating these kinds of relationships

Difficulties varied across countries and within countries. Reasons? (cont.)

3. High differential areas – FT five cents (now ten) over C not enough to match local market prices
4. High-quality/demand areas – better contracts with buyers

Examples

RAOS - Honduras

- Co-op offered 280 lempiras (\$14.8/quintal cherry? = \$.88/lb green) with 150 lempiras (\$.79) up front and the rest in three months
- Middlemen were offering 360 lempiras (= \$1.14/lb green) up front

Manos Campesinas – Guatemala

- EcoLogic – very responsive but not as fast as middlemen – NGO route is not as fast as TNC route
- Sell 100% of their coffee through FT but still only get pre-financing on about 70% of their sales - Small roasters less able to pre-finance
- Particular, trouble managing the differentials – quality has both up and downside
- Appealed to farmer's conscience

Others

- Costa Rica: Coocafe
- Ecuador: Fapecafes
- Guatemala: Finca al Valle
- Guatemala: Manos Campesinos
- Mexico: 21st de Septiembre
- Mexico: La Trinidad
- Mexico: Union de Huatusco
- Nicaragua: Sopexcca
- Rwanda: Karaba

Solutions

1. Expand Ecologic and like institutions

- More financing
- Faster turn around
- In High C environment, financing based on $C + \$0.10 +$ local differential

Solutions (cont.)

2. Flexible pricing system – trigger price + differential
 - say \$1.11 + .40 differential for organic
 - If C price below \$1.11, get $\$1.11 + .40 = \1.41 ; if C price is \$1.20 get $\$1.20 + 0.30 = \1.60

Solutions (cont.)

3. Educating buyers/roasters about importance of financing to co-op's ability to secure deliveries

Solutions (cont.)

4. Enhance member commitment to co-op.
 - deliver other services – dry mills, technical support, other support
 - Wet mill placement – if have wet mill close to farmers, you already have their coffee

Solutions (cont.)

5. Improve quality of coffee – mixed implications for FT, though

Solutions (cont.)

6. Make co-ops better credit risks and produce data to show banks that they are better credit risks
 - Strengthen administrative capacity, financial and inventory management skills etc. of co-ops
 - Many producers of high-quality coffee are better credit risks than banks perceive – need the year-after-year data

Solutions (cont.)

Oxfam Suggests:

1. ICO could provide: “debt refinancing, low interest loans for working capital, long-term capital investment, and access to information and markets.”
2. “ICO could publicly call for a restructuring of the coffee industry so that small-scale farmers have more equal footing with their competitors, mega farms and multinational companies.”